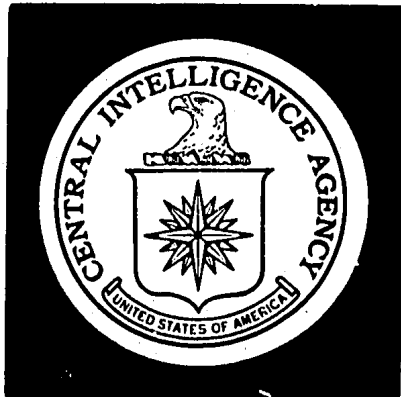


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**DIRECTORATE OF
INTELLIGENCE**

Intelligence Memorandum

The Economic Situation in South Vietnam

Secret

ER IM 71-213
October 1971

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
October 1971

INTELLIGENCE MEMORANDUM

THE ECONOMIC SITUATION IN SOUTH VIETNAM

Highlights

1. Government rice stocks, which provide about half of rice requirements in Military Regions 1 and 2, are expected to be perilously low by the end of November. There apparently is little prospect of replenishing them with rice from the Delta before mid-December. Therefore, emergency rice imports are planned to try to prevent a rice crisis between mid-November and mid-December that could jeopardize the general economic reforms planned for November.

2. Current plans call for President Thieu to announce on 3 November a series of major economic reforms, including devaluation, restructuring of tariffs and domestic taxes, and a wage increase for government employees. The measures are expected to result in moderate overall price increases in the short run, but conspicuous rises in key commodities could trigger a stronger response.

3. Saigon retail prices declined following the 3 October presidential election and on 18 October were only about 8% above prices at the end of 1970.

4. Recent measures enacted to stem the growth of the money supply apparently are taking hold.

5. On 18 October the black market price of dollars was 360 piasters per dollar - down 6 piasters from the pre-election high and down 30 piasters from the average price for December 1970.

6. Charts on foreign exchange reserves, money supply and prices, import licensing, gold and currency prices, and the government budget follow the text.

Note: This memorandum was prepared by the Office of Economic Research.

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DiscussionRice Stock Difficulties

7. Despite a record rice crop this year, there is grave concern that by the end of November government stocks may decline to a level that could lead to a rice shortage in Military Regions (MR) 1 and 2 and set off a wave of speculation in Saigon. While the stock problem should be alleviated when rice from the new Delta crop reaches the market in December, a rice crisis during the next several weeks would have damaging political repercussions and would jeopardize the general economic reform package planned for implementation early in November.

8. Government stocks are an important source of supply. They supply the army nationwide and the civil service everywhere except in MR 4. In the northern half of the country, government stocks meet about half of total requirements. Despite a recent rice harvest in that region that shows output gains greater than expected in the Delta, typhoon damage in MR 1 during 22-23 October will undoubtedly lead to an increased reliance on government rice supplies. Although a comprehensive assessment of damage is not yet possible, the typhoon resulted in losses to that part of the rice still in the fields (perhaps one-fourth of the crop) as well as to farm and millers' stocks.

9. Stocks have declined for two reasons. First, there has been pressure on government stocks because rice from this source is sold much below free market prices. By the middle of October, free market prices were probably 30%-40% above official prices, which were last increased in March.⁽¹⁾ Second, stocks have declined because the government has been unable to buy enough rice from the Delta to replenish them.⁽²⁾ Rice merchants maintain there is not enough surplus rice available in the Delta to meet government requirements. Some observers, however, believe that there is sufficient marketable rice available but that the government is not paying enough to draw it out.⁽³⁾ The merchants claim they are squeezed

1. *Despite the nationwide premium on sales to the private market, there has been no offsetting flow of Delta rice through commercial channels, because of regional price differences and marketing problems.*

2. *The government has not imported any rice from abroad since April.*

3. *Government purchase prices are currently about 5% below the private wholesale price in Saigon.*

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on the one hand by the high cost of credit and on the other by the small margin between what they pay the farmers and what they get from the government.

10. While it seems likely that there is sufficient rice in the Delta to tide government stocks over until the next harvest,⁽⁴⁾ there are a variety of factors that could be operating to discourage farmers from selling. They have already sold more paddy this year and at higher prices than they did in 1970 and thus are in a good cash position to speculate on further price increases. Fear of floods and loss of the new crop also has led farmers to hold their rice. The danger of floods is now past, but farmers still cling to the belief that bad weather comes every five years, and 1971 is the fifth year of the cycle. Fears of political turmoil surrounding the presidential election may also have contributed to farmers' reluctance to sell.

11. Solutions now being considered for the rice stock problem are: (a) to import rice to cover the emergency; and (b) to raise official prices. Preparations are under way to divert PL-480 rice from Indonesia. The argument for increasing the government selling price for rice is based on the belief that government price policy has been the cause for the decline in stocks. According to Embassy reports, the Ministry of Economy is planning to raise official selling prices 12%-16% as part of the wide-ranging reform measures scheduled for early November. This price increase, however, will be too little and too late to relieve pressure on government stocks.

12. Considerable uncertainty will surround the rice issue until the inflow of rice from the new crop in mid to late December. A higher purchase price, subsidy, or some form of coercion might draw enough rice into government stocks. Officials are wary, however, of any move that would lead to substantial price increases at a time when major economic reforms are planned. A rice crisis existed in late 1969 and was a major factor in stirring up the political reaction and inflationary psychology that followed the October 1969 partial devaluation. Saigon retail rice prices, which rose about 20% between March and September this year, were quite stable during the first half of October. Nevertheless, a run on stocks -- possibly by the military quartermaster, as in the past -- could drive rice prices up quickly and trigger price increases in a wide range of other commodities.

4. Current estimates of government needs are 10,000-20,000 metric tons, or only about one-fourth to one-half of an average month's deliveries from the Delta this year. Requirements probably will be somewhat larger, depending on the extent of losses due to the recent typhoon in MR 1.

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Economic Reforms

13. Major economic reforms, still under discussion by US economic advisors and the Vietnamese government, are now expected to be announced in the first week of November. Plans call for President Thieu to center his 1 November inaugural address on broad requirements for economic reform and development and to follow this with an announcement of a reform package on 3 November. The particular reform measures would then be put into effect over the weekend of 6-7 November. Principal components of the reform package will deal with devaluation, restructuring the tariff schedule, and simplifying import procedures. In addition, proposals for reforms of indirect taxes will probably be submitted to the National Assembly, and provision will likely be made for a major government pay raise.⁽⁵⁾

14. Recent US-Vietnamese discussions have focused on the structure of a reformed exchange regime. Although there is no disagreement over the need for devaluation, the spread between proposed rates in the multiple-rate system is a source of concern. The most recent reports suggest that a rate of 400 piasters to the dollar will apply to GVN-financed imports and that imports under the Commercial Import and Food for Peace Programs will be covered by a rate on the order of 275 piasters to the dollar.

15. In addition, provision may be made for a nominally free market for foreign-exchange purchases to be handled by commercial banks and perhaps hotels. This market would be intended to facilitate invisibles transactions, such as purchases of piasters by tourists, and to reduce the volume of foreign exchange purchases now taking place on the currency black market. On the basis of available evidence, it appears that the freedom of operation of the market would be circumscribed by: (a) the setting of buying and selling rates by a government/banking sector board; and (b) restrictions -- perhaps on the amount of individual transactions -- designed to prevent capital outflows. Clearly, the degree to which the new "free" market supplants the black market will depend on the buying and selling rates selected by the board⁽⁶⁾ and on the degree to which particular transactions are inhibited. Presumably, an advantage of the "free" market approach over simply setting a single invisibles rate is that it allows a necessary first step toward building the institutions for further exchange liberalization.

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6. *Indications are that the initial rates would be close to 400 piasters to the dollar.*

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16. In the period immediately following the reforms, GVN attention will be focused on the performance of commodity prices. Inflationary pressures would include the overall piaster devaluation (offset somewhat by reductions of import taxes) and the government pay raise, which is expected to run on the order of 20%. Offsetting these factors in the short run will be a net increase in government revenues from foreign transactions⁽⁷⁾ and any increased saving resulting from the upward revision in the interest-rate schedule in August. The overall result is expected to be a moderate increase in prices toward yearend, but conspicuous rises in key commodity prices could trigger a stronger response. The inherent uncertainty for the short run is a key factor in government anxiety over the level of rice stocks.

Prices

17. Following a 3% increase during the week prior to the presidential election on 3 October, Saigon retail prices then declined through 18 October to a level only 7.7% above those at the end of December 1970. In fact, the USAID index has risen only 10% since July 1970. The gradual acceleration of price increases noted during July-September has at least temporarily halted with prices currently below the mid-September level.

18. Prices of imported commodities, which had been very stable during the summer, began to increase slightly during September. As with the general price level, higher prices for imports probably reflected the uncertainties surrounding the election. By 21 September, however, this index was only 14% higher than at the end of last year, compared with a 33% rise during the comparable period of 1970.

Money Supply

19. The money supply registered an increase of less than half of 1% in August. Although the increase during the first eight months of the year was 17%, almost two-thirds of the increase occurred in the month of January. Preliminary data indicate that, as of mid-September, measures taken in August and early September to increase savings and restrict credit are having the desired effect.

7. *Despite reduction of import taxes, government revenues from foreign transactions are expected to rise with an increase in the revenue from exchange rate margins.*

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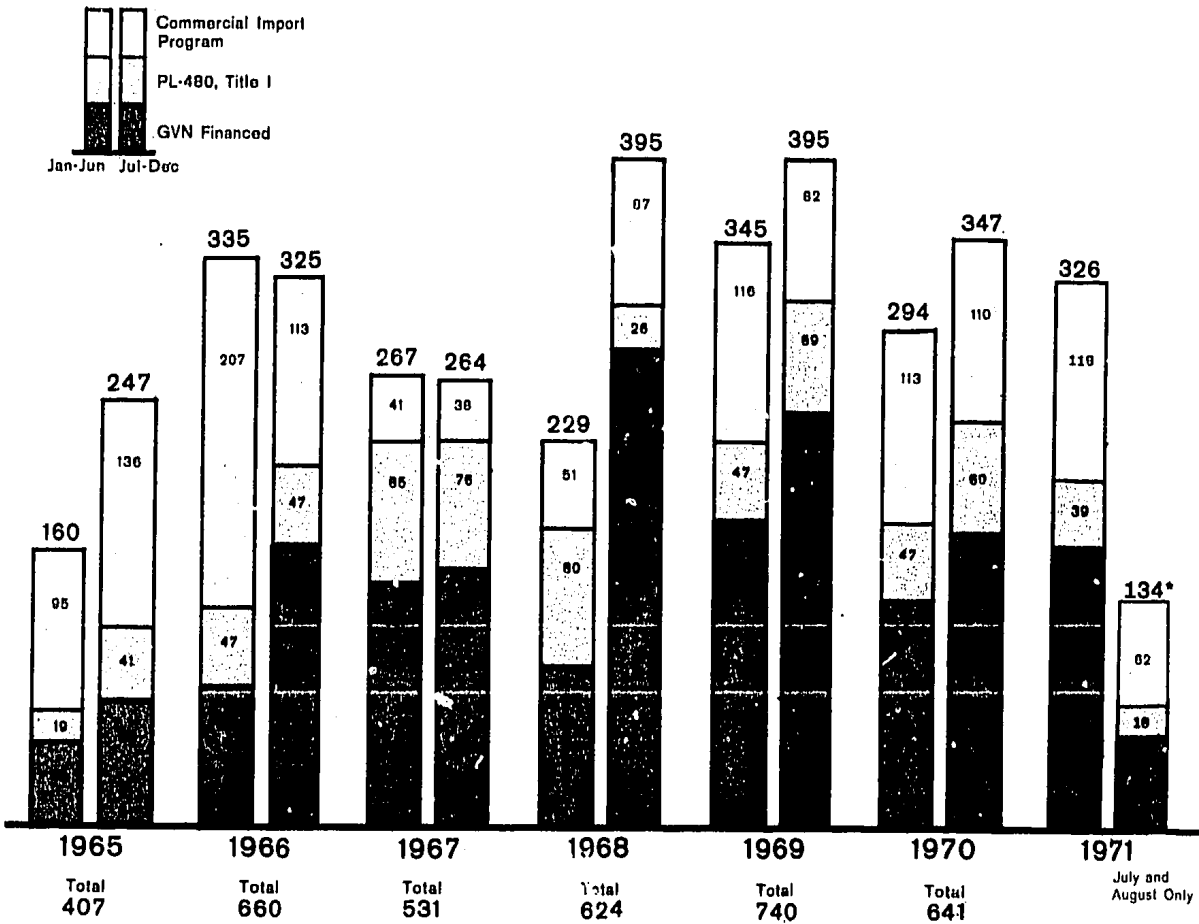
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Currency and Gold

20. Saigon black market dollar prices increased somewhat during the weeks preceding the presidential election, but have since declined. On 18 October the price of dollars was 360 piasters per dollar, or 30 piasters below the average rate for December 1970. The rate for MPC (scrip) -- 263 piasters per dollar on 18 October -- has remained below the legal rate of 275 since February. The price of gold leaf at 505 piasters per dollar is 3% higher than the average price for December 1970.

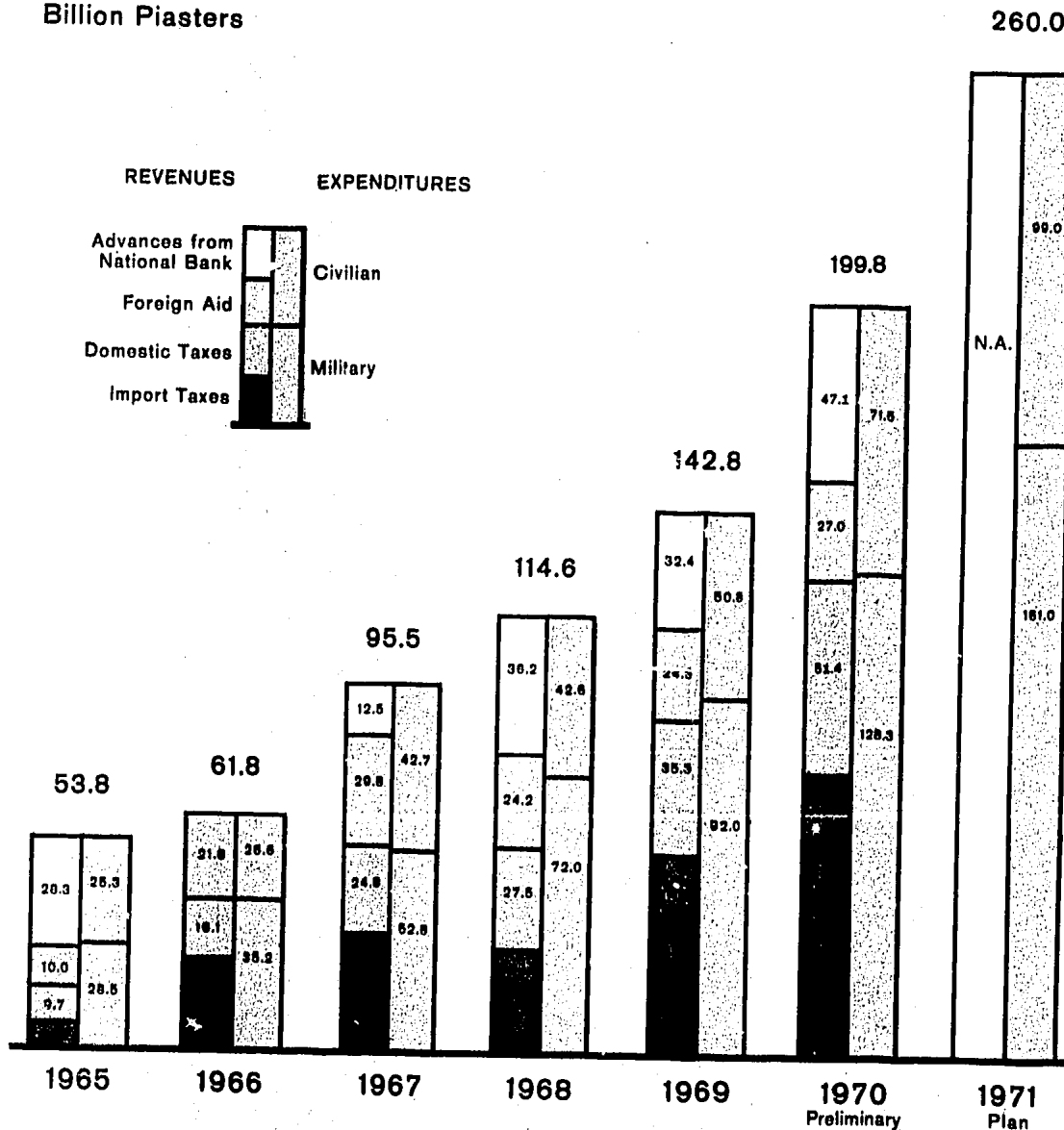
IMPORT LICENSING
Million US Dollars



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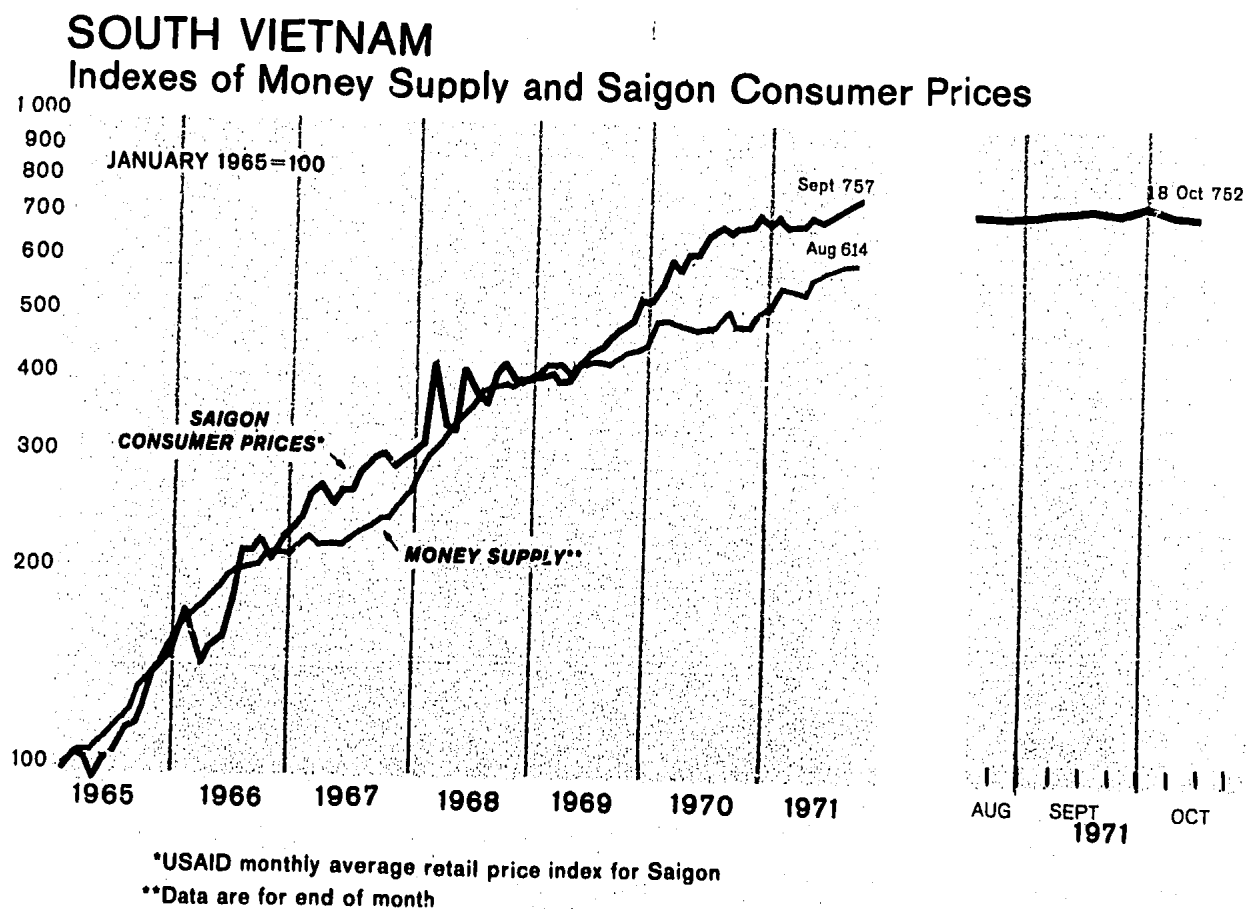
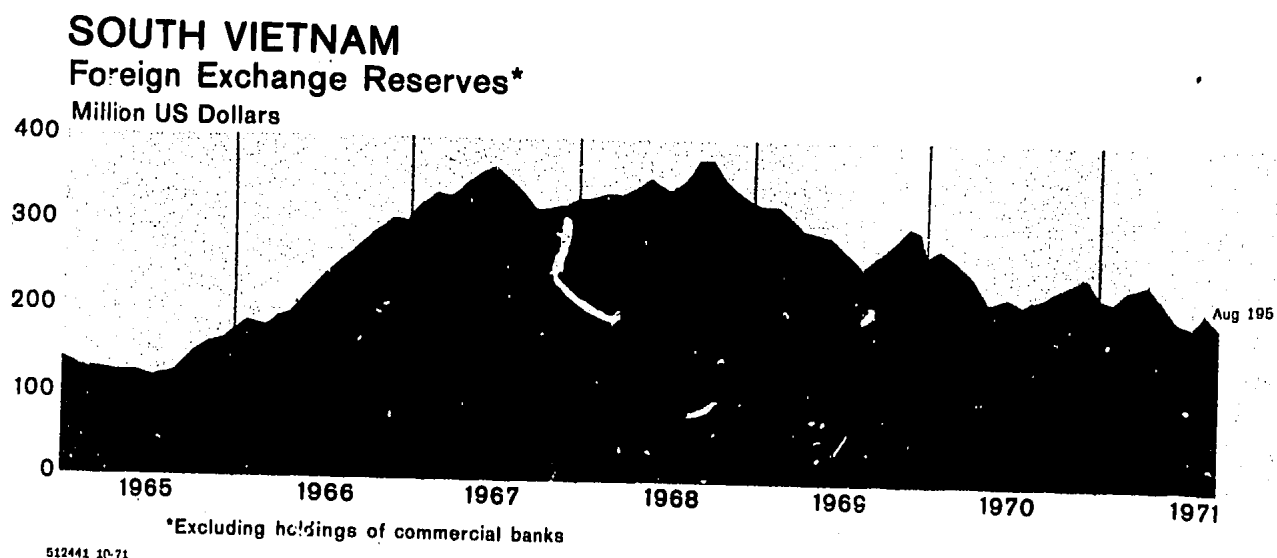
GOVERNMENT BUDGET*

Billion Piasters

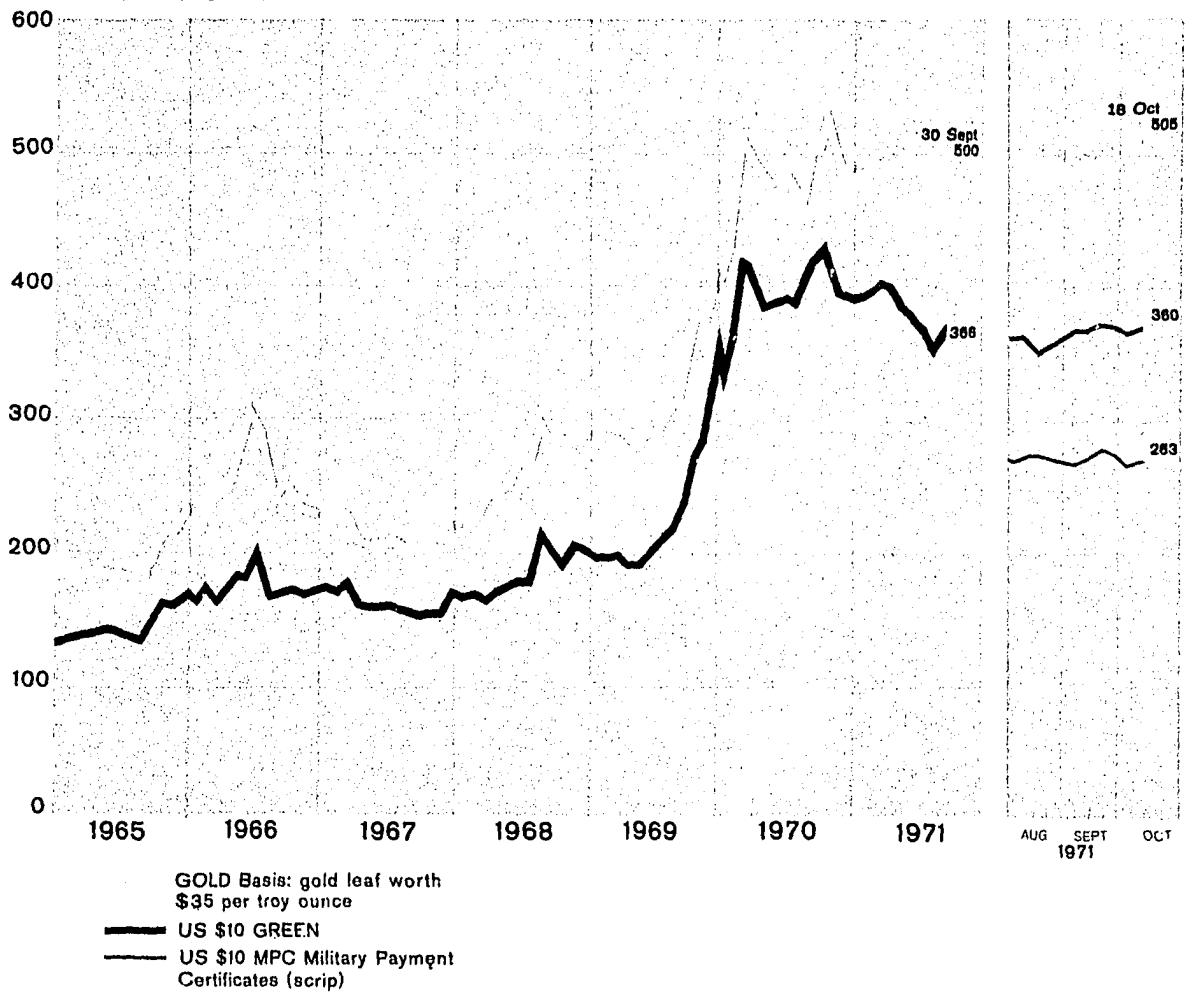


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*Data include extrabudgetary revenues and expenditures



SAIGON
Free Market Gold and Currency Prices
 Piasters Per US Dollar



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